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C O N F I D E N T I A L SECTION 01 OF 04 TAIPEI 003122

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E.O. 12958: DECL: 07/22/2015
TAGS: ECON EINV ETRD EPET CH TW
SUBJECT: TAIWAN PETROCHEMICAL INDUSTRY EAGER TO GET "CRACKING" IN PRC

REF: A. TAIPEI 2601
¶B. TAIPEI 3100

Classified By: AIT Director Douglas H. Paal, Reason 1.5 d

Summary

¶1. (C) Taiwan's petrochemical industry is increasingly focused on cross-Strait trade and investment, with exports to the PRC accounting for up to 50 percent of total output. However, Taiwan's prohibition against investment in the PRC in naptha crackers is holding back even more high-value upstream investment. The Taiwan government has been considering liberalization of naptha cracker investment for some time, but the large amounts of capital required for such investment could make it a contentious political issue. Nevertheless, some Taiwan petrochemical firms are proceeding to develop investment plans, including Formosa Plastics Corp.'s plan for a USD 5 billion complex at Ningbo. State-owned Chinese Petroleum Corp., on the other hand, plans to supply Mainland customers from a proposed USD 11 billion facility in Yunlin County, Taiwan. Further delay in liberalization could impede Taiwan firms' ability to enter the PRC market and give other foreign firms a strong advantage there. In addition, some industry executives fear that PRC trade policy as well as Taiwan environmental concerns could inhibit Taiwan firms from expanding exports to the PRC. As in other cases, the DPP government is letting politics interfere with economic policies that would help Taiwan industry. In the process, it may be aiding KMT efforts to portray it as a party that doesn't understand business. End summary.

Heavy Dependence on PRC Market

¶2. (SBU) Taiwan's petrochemical industry is increasingly focused on cross-Strait trade and investment. According to data from Taiwan's Industrial Technology Research Institute, 64 percent of commodity polymers -- acrylonitrile butadiene styrene (ABS), polyvinyl chloride (PVC), polypropylene (PP), polyethylene (PE), and polystyrene (PS) -- produced in Taiwan are exported. Of those exports 85 percent are destined for the PRC. Sidney Chow, Chairman of the Petrochemical Industry Association of Taiwan (PIAT), estimated that of Taiwan's total petrochemical industry output, nearly half is exported to the PRC. Petrochemicals form a key component of overall cross-Strait trade. Taiwan trade statistics show that organic chemicals accounted for 9 percent of Taiwan's total exports to the PRC in the first four months of 2005.

¶3. (SBU) Petrochemicals industry investment in the PRC is also growing. Taiwan investment data indicate that Taiwan chemical manufacturing firms were approved to invest USD 62 million in the PRC during the first half of 2005. This represented more than 6 percent of all Taiwan investment in the PRC during the period, and made chemical manufacturing the fourth highest industry category. According to data compiled by Taiwan's Chinese Petroleum Corporation (CPC), at least 20 Taiwan petrochemical firms have invested in at least 32 different projects, primarily downstream manufacturing facilities, in the PRC.

Naptha Cracker Domino Effect

¶4. (U) Nevertheless, Taiwan government restrictions on petrochemical investment in the PRC, specifically the prohibition against investment in naptha crackers, are holding back a much higher degree of cross-Strait integration of the industry. Naptha crackers produce most of the inputs for downstream production of petrochemicals and are therefore a lynchpin in the entire supply chain. Many of the chemicals produced by naptha crackers can only be transported economically to downstream facilities by pipeline. Because Taiwan firms cannot build naptha crackers in the PRC, they are limited to investing in those downstream facilities that use inputs that can be easily transported and traded.

¶5. (SBU) Many of the Taiwan manufacturers who consume petrochemicals have moved their factories to the PRC, adding pressure for more petrochemical investment in the PRC farther up the supply chain. Meanwhile, excess production capacity in Taiwan continues to grow. C.T. Lee, President of Formosa Plastics Corp. (FPC), commented to AIT/T that Taiwan's current situation of exporting nearly half of petrochemical output to the PRC is not an economically sound strategy for the industry. He pointed out that the U.S., for example, exports less than 15 percent of petrochemical output.

¶6. (C) Taiwan's petrochemical firms have been active in lobbying the Taiwan government to drop the restriction on naptha cracker investment, and the government has been considering liberalization for at least four years. According to Mainland Affairs Council (MAC) Economics Department Director Fu Don-cheng, naptha cracker investment has not yet been approved because of the amount of capital required for such investment. Taiwan National Security Council Senior Advisor Chen Chung-shin further explained to AIT/T that because any investment in a naptha cracker facility in the Mainland would be so large, approval of this category had important political implications. Chen argued that if the Democratic Progressive Party government were to liberalize naptha cracker investment it would be more vulnerable to criticism from those factions within its Pan-Green alliance that seek to slow the growth of cross-Strait economic ties.

¶7. (C) An economically viable naptha cracker facility would require capital investment in excess of USD 1 billion. Recent naptha cracker investments in the PRC have ranged from USD 2.7 billion for a BP-Sinopec joint venture in Shanghai to USD 4 billion for a Shell-Chinese National Offshore Oil Co. (CNOOC) joint venture at Daya Bay, Guangdong, according to PIAT's Chow. However, industry executives are quick to point out that the amount of capital that Taiwan petrochemicals firms would have to provide would only be a fraction of the total cost. Chow estimates that international and PRC financial institutions would provide 30 to 40 percent of the investment capital and a PRC joint venture partner would provide up to half of the remaining portion.

¶8. (C) Taiwan policymakers might also fear that opening naptha cracker investment will cause the petrochemical industry in Taiwan to "hollow-out." Tsao Minh, Vice President of CPC, speculated to AIT/T that if naptha cracker investment in the PRC were liberalized, the petrochemical industry would abandon Taiwan and move nearly all production to the Mainland. However, Taiwan firms currently appear committed to continuing high levels of production in Taiwan. CPC has plans for a major new facility in Yunlin County, and FPC initiated in 2004 the fourth expansion phase of its USD 19 billion facility also in Yunlin.

Industry Investment Plans Already in Development
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¶9. (C) In anticipation of pending liberalization, Taiwan petrochemical firms are proceeding with the development of naptha cracker investment plans. Chow's firm, USI Group, has been in discussions with Sinopec about possible naptha cracker joint venture options. FPC's Lee described more advanced plans to AIT/T. His firm plans to invest in a USD 5 billion complex in Ningbo. According to Lee, FPC would provide one third of the capital and two thirds would come from Mainland and international banks. FPC also plans to list the new venture to further reduce its own risk in the project.

¶10. (C) CPC's Tsao told AIT/T that because his firm is a state-owned enterprise it has abandoned plans to invest in the Mainland. It had developed a plan for building a naptha cracker facility in Zhenhai, Zhejiang Province, which was rejected by government authorities. Instead the firm plans to take advantage of growth in PRC petrochemical demand with its new petrochemical facility in Yunlin County. The complex will include a refinery, naptha cracker and downstream production facilities and will cost more than USD 11 billion to build. He argued that inexpensive transportation costs will make the Yunlin facility on Taiwan's west coast very competitive in serving the PRC market. Although CPC currently exports only a very small portion of its petrochemical output, Tsao said that the firm expects to export up to 85 percent of the output of the Yunlin plant to the PRC.

Further Delays, More Consequences

¶11. (U) Further delay in approval of naptha cracker investment in the PRC will have a serious impact on the

ability of Taiwan's petrochemical industry to continue to grow. "Petrochemical Industry," a Taiwan trade journal, reports that the PRC's 11th Five-Year Plan starting in 2006 includes a quota for constructing no more than five new naptha crackers. The report indicates that four crackers have already been proposed and Taiwan firms will have to vie for the remaining quota. It suggests that if Taiwan firms are unable to compete for the quota soon, they may have to wait until the next five-year plan in 2011.

¶12. (C) PIAT's Chow emphasized that Taiwan firms are being left behind while other foreign petrochemical companies are expanding in the PRC. In addition to the BP and Shell projects, Chow also noted a USD 3 billion BASF-Sinopec joint venture in Nanjing and an ExxonMobil project in Fujian. He underscored the advantages Taiwan firms have over other foreign firms in the Mainland, due to its geographic and cultural proximity.

¶13. (C) FPC's Lee pointed out potential difficulties should Taiwan petrochemicals be forced to continue serving the Mainland market primarily through exports. He speculated that because the PRC currently imports 40 percent of its energy needs, it may choose at some point to restrict petroleum and petrochemical imports. He also fears that because such a high portion of Taiwan's petrochemical output is exported to the Mainland, the PRC may threaten to impose anti-dumping duties.

¶14. (C) CPC's strategy of supplying the PRC market from expanded production in Taiwan is not without pitfalls. Plans for the Yunlin petrochemical facility have met fierce opposition from some environmental groups (as reported ref A). After initially receiving approval for the project from the Executive Yuan, CPC has had to perform additional environmental studies. Tsao told AIT/T that he now expects the Taiwan government to wait until after local elections scheduled for December 3 to give final approval for the project. In addition, further expansion of the petrochemical industry in Taiwan may be constrained by Taiwan's efforts to comply with Kyoto Protocol emissions standards.

Comment

¶15. (U) The petrochemical industry is an example of profound cross-Strait economic ties that vary from the well known model of Taiwan firms building labor-intensive assembly plants in the Mainland to produce consumer goods for export to the U.S., Japan and Europe. The industry relies heavily on demand from the Mainland market and is eager to invest large amounts of capital in upstream production. There is already substantial cross-Strait integration within the industry that will only become more profound when and if Taiwan relaxes investment restrictions.

¶16. (C) It also provides another example of Taiwan domestic politics interfering with economic policies that would allow Taiwan firms to further capitalize on the PRC's remarkable economic growth. When explaining the Chen Shui-bian administration's reluctance to move forward with cross-Strait economic initiatives at this time, the NSC's Chen explained that the PRC and Taiwan's opposition Kuomintang (KMT) Party are cooperating with each other in an effort to portray the ruling DPP as unable to manage economic issues (reported ref B). He claimed that the DPP government could not proceed with cross-Strait liberalization at a time when it would be perceived to be yielding to pressure created by KMT cross-Strait economic initiatives. When discussing the naptha cracker investment issue, both PIAT's Chow and FPC's Lee were quick to criticize the DPP government and described its leadership as being ignorant about business. If the DPP government continues to delay naptha cracker liberalization as well as other cross-Strait economic initiatives, it may only strengthen an image of incompetence that it accuses the KMT of trying to create. End comment.
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